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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 389

THE CANISTER COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (R. 21–26) is reported at 70 F. Supp. 904.

JURISDICTION

The judgment of the Court of Claims was entered on April 7, 1947. (R. 27.) Petitioner filed a motion for new trial on June 6, 1947. The motion for new trial was overruled on July 7, 1947. (R. 27.) The petition for a writ of certiorari was filed on October 6, 1947. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended.

QUESTION PRESENTED

Whether the evidence presented to the Court of Claims required judgment in petitioner's favor for refund of income tax paid by petitioner for its fiscal year ended April 30, 1941.

STATUTES INVOLVED

Internal Revenue Code:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; * * *.

* * * * *

(26 U. S. C. 1940 ed., Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) * * *.

(B) * * * then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U. S. C. 1940 ed., Sec. 113.)

Sections 203 (b) (4) of the Revenue Acts of 1924, c. 234, 43 Stat. 253, and 1926, c. 27, 44 Stat. 9, contain provisions identical with the quoted portion of Section 112 (b) (5) of the Internal Revenue Code.

STATEMENT

The facts found by the Court of Claims (R. 15–21) may be summarized as follows:

The petitioner is a New Jersey corporation organized April 19, 1924, by one Raphael T. Garfein, now known as Raphael T. Gwathmey. He has been petitioner's president and sole stockholder at all times since its organization. On August 14, 1941, the petitioner filed its final income and excess profits tax returns for its fiscal year ended April 30, 1941, showing an income tax liability of $7,735.99 and excess profits tax liability of $1,823.96. The taxes shown due on the returns were duly paid in quarterly installments. (R. 15, 16.)

Pursuant to a Revenue Agent's report dated February 27, 1943, the Commissioner of Internal Revenue, on June 16, 1944, notified petitioner of his determination of an overassessment of income tax for the fiscal year 1941 in the amount of $3,351.99 and a deficiency of excess profits tax for the same year in amount of $3,011.88. On July 11, 1944, the petitioner filed a claim for refund of the amount of overassessment of income taxes shown. On October 19, 1944, the Collector of Internal Revenue at Newark, New Jersey, transmitted to petitioner a "Notice and Demand" showing the assessed deficiency of excess profits tax and interest for 1941 totaling $3,598 and an offset of the determined overassessment of income tax for the same year in the amount of $3,351.99. The demand for payment was for the difference, or balance due, of $246.01. On January 17, 1945, the petitioner delivered to the Collector its check for $3,598, representing the entire amount of the deficiency of excess profits tax and interest assessed against it for 1941. (R. 16, 17.)

In the computation of petitioner's tax liability for 1941, the petitioner had been allowed depreciation deductions for the year aggregating $16,973.21. However, by a Revenue Agent's report dated February 15, 1945, the same investigating Agent recommended reduction of the allowable depreciation for 1941 to $9,505.53. The Agent's adjustments of original book valuations of assets

acquired by the petitioner in 1924 and 1926 from Garfein (Gwathmey), which had not previously been fully depreciated, provided the basis of the changed allowance recommended for the fiscal year 1941. The revision of petitioner's depreciation account resulted in a recomputation of the petitioner's excess profits tax liability for 1941 showing a deficiency therein, barred from assessment by the applicable statute of limitations, in excess of the amount of the previously determined overassessment of income tax. The petitioner was notified by letter dated March 12, 1945, that its claim for refund for $3,351.99 would be disallowed accordingly. (R. 18.)

By a bill of sale executed April 22, 1924, The Canister Company of New Jersey (not connected with the petitioner) sold and transferred to Garfein (Gwathmey) the fibre can business previously conducted by that corporation, together with the good will thereof and the equipment used in the business. The bill referred to an itemized list of the equipment attached as Schedule A. The consideration for the sale was $100,000. The bill also authorized the buyer to assign the entire agreement to a corporation to be organized by him and to be known as "The Canister Company." The petitioner immediately took over from Garfein (Gwathmey) all assets referred to in the bill of sale and made opening entries in its journal showing them valued at $238,085.37. Petitioner

issued its stock to Garfein (Gwathmey) in the amount of $163,085.37 and assumed his liability for $75,000, represented by his notes in that amount given to the corporation from which he had acquired the assets. Petitioner's journal entry contained the explanation "Stock issued for the business formerly owned by The Canister Co. of N. J. and sold to The Canister Company by R. T. Garfein. Note issue payable equal yearly maturities—First maturity Sept. 1, 1925." In June 1924 petitioner's journal shows additional assets acquired from Garfein consisting of patents valued at $24,081.87 and good will valued at $42,832.76, against which petitioner issued additional common stock to Garfein in the amount of $66,914.63. That completed the issuance of the entire authorized capital stock of petitioner in the amount of $250,000. (R. 18–20.)

On April 22, 1924, The Canister Company of New Jersey leased to Garfein for a period of five years the manufacturing plant formerly occupied by the lessor. The lease authorized him to assign all rights thereunder to the petitioner, and such assignment was executed on April 24, 1924. The lease also contained an option to purchase the leased property at any time during the term of the lease for $100,000. (R. 20.)

In March 1926 petitioner recorded in its journal the plant property purchased by Garfein per-

sonally and by him turned over to petitioner at the following values (R. 20):

Land	$25,000.00
Buildings	300,957.35
Equipment	16,027.62
Total	341,984.97

On April 12, 1926, The Canister Company of New Jersey conveyed direct to petitioner the land and buildings which were subject to the lease outstanding to Garfein. (R. 21.)

As its basis for depreciation deductions for all taxable years from the dates of acquisition in 1924 and 1926 through 1941, petitioner used the values set up on its journal as shown above. (R. 21.)

ARGUMENT

The petitioner in the Court of Claims elected to rest its claimed right to recover an alleged overpayment of income taxes for its fiscal year ended April 30, 1941, on the presumptive correctness of a Revenue Agent's report dated February 27, 1943, and a letter transmitted to it by the Commissioner of Internal Revenue on June 16, 1944, finding an overassessment of income tax for the fiscal year ended April 30, 1941. The Government, contending that this determination of petitioner's tax liability for 1941 was erroneous, introduced evidence showing that the Agent had made a second investigation and report dated February 15, 1945, disclosing an actual deficiency

of excess profits tax due for 1941 in excess of the amount of the previously determined overassessment of income tax. Although the deficiency was barred from assessment by the applicable statute of limitations, no question has been raised as to the right of the Commissioner to offset the excess profits tax deficiency thus found against the income tax overassessment. Cf. *Lewis* v. *Reynolds*, 284 U. S. 281. The report of February 15, 1945, was approved and constituted the final determination of petitioner's tax liability for 1941 by the Bureau of Internal Revenue. The basis of the revision of petitioner's tax liability for 1941 was the Agent's adjustment of petitioner's original costs of assets acquired in 1924 and 1926 as they appeared in petitioner's depreciation accounts.

In no way has petitioner challenged the correctness of this final determination of its tax liability for 1941. Its case rests on the premise that the Government's position was not supported by sufficient competent evidence. The evidence shows, however, that in 1924 Garfein (Gwathmey) acquired for cash and personal notes the going business and fibre can manufacturing equipment which had previously been operated by The Canister Company of New Jersey. The business has since been operated by petitioner. The Canister Company of New Jersey was dissolved long ago. In 1926 Garfein acquired title to the plant

real estate in the same manner and from the same corporation. Immediately upon acquisition of properties in 1924 and 1926, Garfein transferred them to this petitioner for its entire capital stock and certain credits to his account on petitioner's books. From the available evidence it is clear that Garfein's total costs for the assets were $100,000 for those acquired in 1924 and $70,000 for those acquired in 1926. Under the provision of Sections 112 (b) (5) and 113 (a) of the Internal Revenue Code, and corresponding provisions of the Revenue Acts of 1924 and 1926, *supra,* the petitioner's basis for the assets was the same as Garfein's, yet the petitioner opened its books by valuing the assets acquired in 1924 from Garfein at $238,085.37, of which the books ascribed $221,626.64 to depreciable items. For the property acquired in 1926 from Garfein, petitioner set up a value in its books of $341,984.97, including depreciable items of $316,984.97. The Bureau of Internal Revenue has determined that the assets were entered on petitioner's books as a basis for subsequent depreciation at a value far in excess of their costs. That determination carries the presumption of correctness. See *McIlhenny* v. *Commissioner,* 39 F. (2d) 356 (C. C. A. 3d); *Burnet* v. *Porter,* 283 U. S. 230; *Mollohon Mfg. Co.* v. *United States,* 80 C. Cls. 35, 8 F. Supp. 725; *Cerro de Pasco Copper Corp.* v. *United States,* 82 C. Cls. 442, 13 F. Supp. 633, certiorari denied, 298 U. S. 686; *Wilson & Co.* v. *United States,* 82 C.

Cls. 261, 15 F. Supp. 332. Insofar as it is inconsistent with the determination made in 1941, it supplants the earlier determination which is no longer presumed to be correct. *Austin Co.* v. *Commissioner,* 35 F. 2d 910 (C. C. A. 6th), certiorari denied 281 U. S. 735.

Depreciation allowances involve primarily questions of fact. Petitioner's burden in this case, as in any other action for recovery of internal revenue taxes in the Court of Claims, was to establish the illegality of the collection and petitioner's right to recover as claimed. *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357, affirming 67 C. Cls. 693; *Rosenstadt & Waller* v. *United States,* 79 C. Cls. 698, 7 F. Supp. 287. The petitioner has not met this burden. The taxpayer's book entries are not conclusive of amounts of depreciation actually sustained. *Globe-Wernicke Co.* v. *United States,* 80 C. Cls. 105, 8 F. Supp. 711. It appears proper to note that petitioner's president and sole stockholder since the date of its organization—and the only man alive with first-hand information of all the facts relevant to petitioner's acquisition of assets—failed to testify, either in support of petitioner's claim or in refutation of the testimony and documentary evidence introduced by the Government through the Revenue Agent. As to the inference which may properly be drawn from such failure, see *Mammoth Oil Co.* v. *United States,* 275 U. S. 13, 51, 52; *Runkle* v. *Burnham,* 153 U. S. 216; *Kehoe*

v. *Commissioner,* 105 F. 2d 552 (C. C. A. 3d), reversed on other grounds, 309 U. S. 277.

The petition for certiorari in this case presents no reviewable question to this Court. *Luckenbach S. S. Co.* v. *United States,* 272 U. S. 533. Bringing before this Court only the Court of Claims findings of fact, without all the evidence relied on by the court to support its findings, the petitioner asks this Court to review the judgment on the ground that one exhibit referred to in the findings was incomplete and was improperly admitted in evidence. This Court has often stated that it would not exercise such functions on certiorari to the Court of Claims. See *Luckenbach S. S. Co.* v. *United States, supra,* at pp. 538, 539.

The only possible exception to the foregoing would appear to be in a case where under Rule 38 (5) (b) of the Supreme Court, made applicable to the Court of Claims by Rule 41 (3), this Court found that the lower court had so departed from the accepted and usual course of judicial proceedings as to call for an exercise of the Supreme Court's power of supervision. Manifestly there is no warrant in this case for the application of that rule. The Court of Claims received all the evidence presented by petitioner and decided the case against petitioner on the entire record. The petitioner disagrees with the result and contends here that the court below

placed undue reliance upon a document alleged to have been erroneously admitted in evidence. The respondent disagrees with the petitioner on all counts, but respectfully submits that no question has been properly presented to this Court for review. Cf. *Cramp* v. *United States,* 239 U. S. 221; *McClure* v. *United States,* 116 U. S. 145; *Luckenbach S. S. Co.* v. *United States, supra.* There was substantial evidence introduced in the court below to support the court's judgment even without the challenged document.

CONCLUSION

The decision below does not result in any conflict. The question is one of fact and is not of general importance. The record presented to this Court does not present any question subject to this Court's review. The petition should, therefore, be denied.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
HELEN R. CARLOSS,
GEORGE A. STINSON,
J. W. HUSSEY,
Special Assistants to the Attorney General.

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